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Assessing the Impact of Israel-Iran Conflict on Global Energy Prices

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Executive Summary

The escalating tensions between Israel and Iran have heightened geopolitical risks, leading to a surge in oil prices, with Brent crude trading at $74 per barrel, up 7% on the day. We expect oil prices to remain supported at current levels, with a potential upside to $100 per barrel if the situation escalates further. This uncertainty could lead to a flight to safe-haven assets such as gold, the US dollar, and sovereign bonds, and defense stocks, utilities, and defense contractors could be protected in this environment. The structural changes in the oil market, driven by shifting demand and supply dynamics, are likely to have significant implications for investors, with the refining sector expected to be particularly affected. We believe that investors should focus on companies with strategic advantages in the petrochemical sector, as well as those positioned to benefit from the growth in biofuels production and NGLs.

Brent crude surged by 7% in a single day — **$74**

20% — **Of global oil flows through the Strait of Hormuz**

Expected oil demand growth (2024–2030) — **2.5 mb/d**

680 kb/d — **Expected growth in global biofuel production by 2030**

Geopolitical Tensions and Oil Markets

1

The recent escalation of the Israel-Iran conflict has led to a significant surge in oil prices, with Brent crude and WTI crude oil prices increasing by 7% and 6%, respectively. We believe that the conflict's impact on oil prices will be closely tied to the potential disruption of Iran's 5% global oil supply. The market reaction has been swift, with European futures and S&P500 futures pointing to significant losses, and risk sentiment likely to be weighed down by the conflict.

The options market suggests that traders remain bullish on the medium-term outlook for oil, with September call options for Brent crude at a $95 strike price, positioning for a potential surge to $100 per barrel or more. We note that the gold price is rising, hurtling towards a new record high, and could surge beyond $3,500 if the escalation continues or a nuclear threat arises. The dollar has proven its credentials as a haven, strengthening against G10 currencies, except for the yen and Swiss franc, as investors seek safe-havens.

Market Reaction and Future Outlook The market reaction to the escalating tensions in the Middle East is likely to be significant, with European futures and S&P 500 futures pointing to a substantial drop. We believe that the dollar's rally is likely to be temporary, and it will remain weak in the medium to long term. However, if the situation does escalate, we could see a surge in safe-haven assets and a further increase in oil prices. Investors need to price in the potential impact of higher oil prices on interest rates, which could lead to rate cuts from the US and Europe. Overall, we expect the situation to dominate market sentiment in the coming days, with a focus on safe-haven assets and defense stocks.

The conflict has reignited memories of the oil market shock following Russia's invasion of Ukraine in 2022, which pushed Brent crude to over $139 per barrel and WTI to $133. Central banks may face a bind, wanting to lower interest rates to support slowing economies while rising energy costs risk reigniting inflation, potentially forcing monetary authorities to delay or reverse planned rate cuts.

The Strait of Hormuz, a critical waterway through which 20% of the world's oil flows, is at the center of global energy market anxiety, with a potential closure or disruption threatening to send shockwaves through oil markets. A military clash between Iran and Israel escalates tensions in the region, increasing the risk of disruption to oil supplies and causing anxiety in financial markets.

The market reaction has been swift, with oil prices spiking, gold jumping, and equities taking a beating, as investors seek safe-havens and re-evaluate their risk exposure. The inflation risk is significant, as a sustained rise in crude prices can work its way into consumer prices, and if oil stays high, inflation will tick back up, making rate cuts harder to justify.

We believe that the current situation is likely to have a moderate impact on oil prices, given the spare capacity among oil producers and the global economic conditions. However, the key factors influencing oil prices are the duration of the Israel-Iran conflict, whether other countries are drawn in, and whether the US intervenes to de-escalate the situation. A critical risk factor is the potential disruption to shipping in the Strait of Hormuz, which could impact about a fifth of the world's oil production.

Strait of Hormuz: The Strategic Chokepoint for Global Oil Supply chains

Source: [BBC]

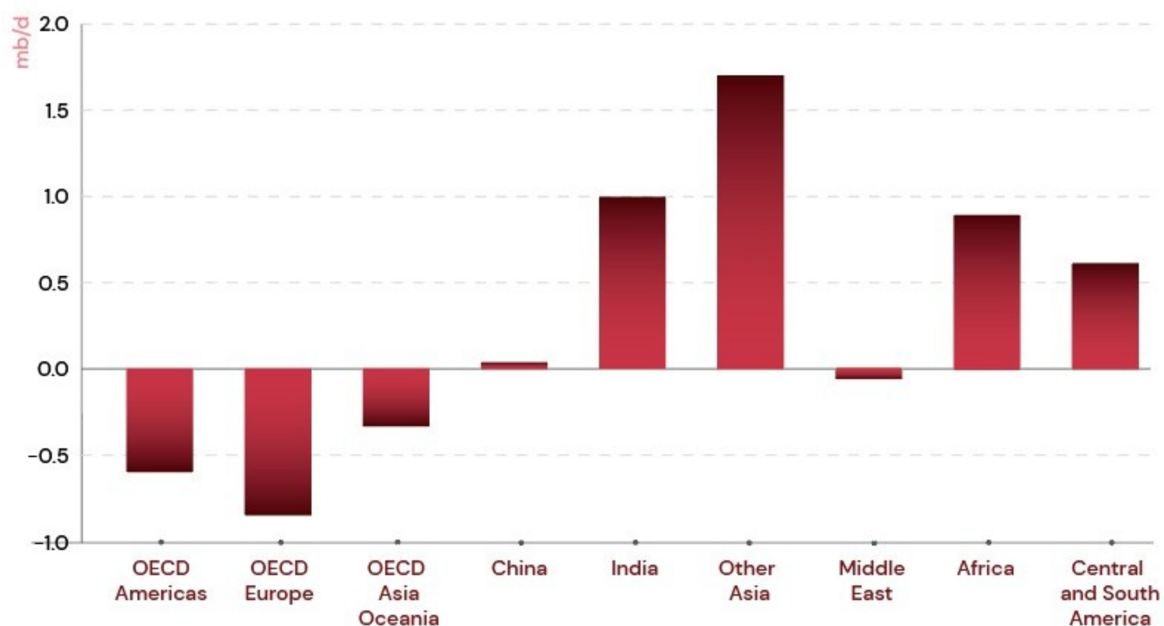
Shifting Oil Market Dynamics: A Well-Supplied Market with Geopolitical Risks

2

Global oil demand is forecast to increase by 2.5 million barrels per day (mb/d) between 2024 and 2030, reaching 105.5 mb/d by the end of the decade. India's oil demand is expected to rise by 1 mb/d, the highest among all countries, driven by strong GDP growth. However, global annual demand growth is projected to slow down from 700 kb/d in 2025-2026 to a near-stagnant growth in subsequent years. The transport and power generation sectors are driving a shift away from oil, contributing to slowing demand growth. Global oil production capacity is expected to rise by over 5 mb/d to reach 114.7 mb/d by 2030. The increase in global oil production capacity will be led by Saudi Arabia and the United States. China's oil consumption in 2030 is now expected to be only marginally higher than in 2024, a significant downgrade from previous forecasts.

Evolving Oil Demand and Supply Landscape. The global oil market is undergoing significant structural changes as the drivers of supply and demand growth shift. According to the IEA's medium-term outlook, global oil demand is forecast to increase by 2.5 million barrels per day (mb/d) between 2024 and 2030, reaching a plateau of around 105.5 mb/d by the end of the decade. Meanwhile, global oil production capacity is expected to rise by more than 5 mb/d to 114.7 mb/d by 2030, driven by robust gains in natural gas liquids (NGLs) and other non-crude liquids. We believe this growth in non-crude capacity is driven by strong global demand for petrochemical feedstocks and the development of liquid-rich gas resources.

Growth in world oil demand by selected countries and regions, 2024-2030



Source: Down to Earth, IEA

The Shifting Role of Key Players. The traditional drivers of oil demand and supply growth are losing steam. China, which has driven global oil demand growth for over a decade, is set to see its consumption peak in 2027, due to a surge in electric vehicle sales and the deployment of high-speed rail and trucks running on natural gas. In contrast, the US oil supply is expected to grow at a slower pace as companies focus on capital discipline. Despite this, the United States remains the single largest contributor to non-OPEC supply growth in the coming years. We expect to see a significant shift in the global oil market landscape as emerging trends, such as electric vehicles and renewable energy sources, increasingly impact oil demand growth.

Implications for the Refining Sector and Investment Opportunities. The petrochemical industry is poised to become the dominant source of oil demand growth from 2026 onwards, with demand for oil from combustible fossil fuels potentially peaking as early as 2027. This trend is likely to impact the refining sector, with net refinery capacity expected to far exceed demand for refined products in 2030, potentially leading to capacity shutdowns. We believe that investors should focus on companies with strategic advantages in the petrochemical sector, as well as those positioned to benefit from the growth in NGLs and other non-crude liquids. The increasing importance of petrochemical feedstocks and the development of liquid-rich gas resources may also create new investment opportunities in the energy sector.

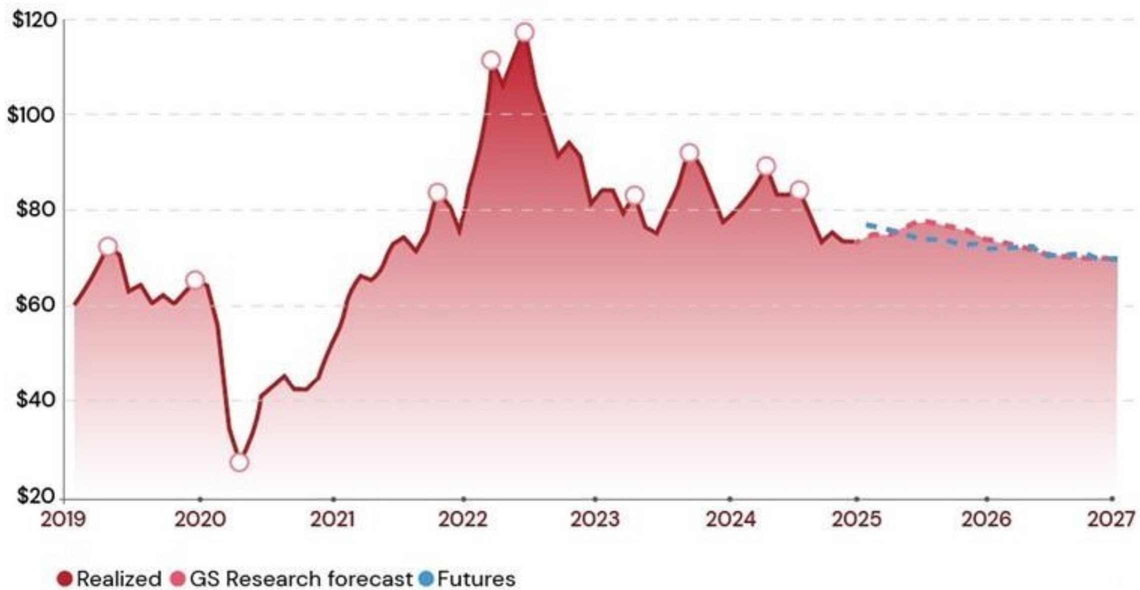
Investment Implications and Thematic Trends. The structural changes in the oil market, driven by shifting demand and supply dynamics, are likely to have significant implications for investors. We believe that the refining sector will be particularly affected, with net refinery capacity expected to far exceed demand for refined products by 2030. This could lead to consolidation in the sector, with less efficient refineries potentially shutting down. On the other hand, the growth in biofuels production, expected to grow by 680 kb/d between 2024 and 2030, presents opportunities for investors in the renewable energy space. We expect Brazil and India to lead ethanol output growth, adding 140 kb/d and 100 kb/d respectively, and together accounting for 70 per cent of the total increase. This shift towards biofuels and away from fossil fuels presents a compelling investment theme in the energy sector.

Oil Prices to Remain Range-Bound Amid High Spare Capacity

3

Range-Bound Oil Prices Expected in 2025. Goldman Sachs believes that oil prices will trade in a range of $70-$85 per barrel in 2025, driven by high spare capacity among OPEC+ producers and the price elasticities of OPEC and shale supply. Research forecasts that Brent crude oil will average around $76 per barrel this year, with prices influenced by the rate of production in non-OPEC countries and geopolitical factors such as sanctions and tariffs. The market's expectation of a large surplus in oil production in 2025 may cap prices, with some forecasters predicting a surplus of up to 1.2 million barrels per day, while others predict a deficit. We expect a modest surplus of 0.4 million barrels per day, driven by an increase in production from non-OPEC nations, particularly the US, Canada, Brazil, and Guyana.

Brent is forecast to trade between $70-$85 per barrel this year



Source: [Goldman Sachs]

Resilient Oil Demand Growth Expected The industry expects oil demand to grow for another decade, driven by emerging market demand for energy as their GDP grows at nearly 4% a year in the second half of this decade. As income rises in emerging markets, so will demand for road and air transportation. However, efforts to decarbonize are particularly challenging when it comes to plastics and air travel. We forecast that the global number of air passengers will rise by 100% by 2040, while EV sales are expected to weigh on oil demand in the medium term, with the drag on global oil demand growth from EV sales currently standing at around 0.4 million barrels a day and increasing to nearly 0.6 million barrels by 2026.

Geopolitics to Play a Significant Role in Energy Prices Geopolitical events will continue to have a significant influence on the oil market next year, with the potential for prices to break out of the $70-85 range. We believe that a disruption to Iranian oil supply, reflecting tighter sanctions enforcement, could drive Brent prices to the mid-$80s per barrel by mid-2025. Conversely, broader-than-expected tariffs from the US could drive down the price of oil in the medium term, with Goldman Sachs Research estimating that Brent could drop to the low $60s by the end of 2026 in a scenario where the US imposes an across-the-board tariff of 10%.

The global economy is facing tougher times, which could limit the impact of higher energy costs on inflation, and oil producers have the capacity to increase supply to help lower prices. The situation bears some similarities to the 2022 Ukraine conflict, but also some key differences, including the current weaker global economy and lower oil prices. The forecasts for the oil production surplus/deficit vary widely, ranging from 1.2 million barrels per day surplus to a deficit. Goldman Sachs Research forecasts a modest surplus of 0.4 million barrels per day in oil production. The petrochemical sector is set to become the dominant source of oil demand growth from 2026 onwards, consuming one in every six barrels of oil by 2030. Demand for oil from combustible fossil fuels may peak as early as 2027, while jet fuel consumption is expected to continue growing. Net refinery capacity is likely to far exceed demand for refined products in 2030, potentially leading to refinery capacity shutdowns in the interim. Oil inventories have been rising steadily, but OECD inventories remain 97 million barrels below 2024 levels, reflecting ongoing volatility in market sentiment.

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